



FEDERAL ELECTION COMMISSION
WASHINGTON, D.C. 20463

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MEMORANDUM

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SUBJECT: Draft Final Audit Report for McCain-Palin 2008, Inc. and McCain-Palin Compliance Fund, Inc. (LRA 759)

I. INTRODUCTION

The Office of the General Counsel has reviewed the proposed Draft Final Audit Report ("DFAR") for McCain-Palin 2008, Inc. (the "General Committee") and McCain-Palin Compliance Fund (the "GELAC"). We generally concur with the findings in the DFAR and specifically comment on Finding 1: Campaign Travel Billing for Press. If you have any questions, please contact Delanie DeWitt Painter, the attorney assigned to this audit.

II. CAMPAIGN TRAVEL BILLING FOR PRESS – BACKGROUND

The auditors reviewed travel billing and press reimbursements and concluded that the General Committee must refund \$344,892 to the press for excessive reimbursements.

The press traveled with the presidential candidate on a plane chartered through Swift Air LLC ("Swift Air"). John McCain 2008, Inc. ("Primary Committee") had used the same chartered airplane during the latter part of the primary campaign. The auditors calculated the total actual transportation cost to the press as \$3,756,215. They determined that the maximum that the General Committee could bill the press was 110% of this actual cost, \$4,131,836. The General Committee billed the press \$4,503,658 and, in response to those bills, received reimbursements of \$4,476,728. Thus, the auditors conclude that the General Committee must refund the excessive amount of \$344,982 (\$4,476,728 -- \$4,131,836) to the press. The excessive reimbursements were primarily caused by the Committee's method of calculating the actual travel costs on the leased airplane from Swift Air.

In response to the Preliminary Audit Report ("PAR"), the General Committee contends that it used a "reasonable process" to "predict the eventual, proper allocation" of press reimbursements between the General Committee and the Primary Committee. PAR Response at 3-5. It argues that its calculation method is more consistent with past Commission audits. *Id.* at 6-9. Further, it asserts that its calculation is more consistent with Generally Accepted Accounting Principles ("GAAP"). *Id.* at 9-11. Finally, the General Committee argues that to the extent a misallocation of press reimbursements between the committees still exists, the General Committee may correct the imbalance by making a payment to the Primary Committee. *Id.* at 11-13. The General Committee's arguments are discussed in more detail below. We do not find the General Committee's arguments persuasive.

The Swift Air charter contract for the leased aircraft covered a portion of the primary campaign and the entire general campaign and ran between June 30, 2008 and November 15, 2008. The contract was signed on behalf of the Primary Committee, but the General Committee appears to have assumed the payments and terms of the contract and made weekly payments to Swift Air during the general election period. The total contract cost was \$6,384,000, to be paid in 19 weekly payments of \$336,000. The contract entitled the campaign to 22.4 flight hours per week for a total of 425.6 flight hours for the entire contract. Flight hours in excess of 22.4 hours per week were to incur additional charges and unused hours could be rolled over to later weeks. The Primary Committee and General Committee remained liable for the total contract cost of \$6,384,000 even if fewer than 425.6 hours were flown by the end of the contract, and were entitled to no refund or rebate for flight hours that remained unused at the end of the contract. Neither the Primary Committee nor the General Committee used up the flight hours that they were entitled to use; the Primary Committee used 111.8 flight hours and the General Committee used 140.3 flight hours. The Primary Committee paid Swift Air \$336,000 per week each week for nine weeks and the General Committee paid the same weekly amount each week for ten weeks during the general election period. Over the ten weeks it had the aircraft, the General Committee paid Swift Air a total of \$4,047,402; which included the contract cost of \$3,360,000 plus \$687,402 for fuel, catering, passenger taxes and ground handling fees as required by the contract.

To determine the amount that the General Committee could receive in press reimbursements, the General Committee had to calculate the pro rata share of the actual cost of travel for each passenger. The General Committee and the Audit Division used two different methods to calculate this pro rata share.

The General Committee's calculation was based on the cost over the entire life of the contract and included the entire amount that the General Committee paid as well as a portion of the amount that the Primary Committee paid on the contract. Specifically, the General Committee's calculation is based on the combined actual flight hours that both committees used during the campaign and the total contract cost. The committees estimated the flight hours and adjusted the estimate on a segment-by-segment basis. Using this method of calculating the actual travel cost, the General Committee claims that it received press reimbursement of only 106% of the actual cost – less than the regulatory maximum of 110%.

The General Committee asserts that it was not easy to determine the actual cost of travel in advance because the Swift Air travel cost could be calculated only at the end of the contract, when the committees would know how many hours had been flown and could then divide the total contract cost. PAR Response at 3. It argues that because the committees could only "predict the proper hourly rate," they continually adjusted each new travel segment "based on the evolving total of estimated hours to be flown" under the contract. *Id.* at 4. The committees realized that the contract straddled the primary and general election periods and anticipated that they would need to later "rebalance" the press reimbursements between them when the actual hourly rates were known, after the 2008 election. *Id.* The Committee argues that "a particular week's fixed installment payment was *not* in exchange for that week's flight hours." *Id.* at 5.

The Audit Division took a different approach to calculate the pro rata share of the actual cost of travel and concludes that the General Committee received reimbursements in excess of the maximum 110%. It looked only at the actual cost paid by the General Committee to Swift Air for travel during the general election portion of the contract, not the entire cost of the contract over its entire life during both the primary and general campaigns. The auditors' calculation was based on the \$336,000 weekly payments to Swift Air, as well as costs for fuel, catering, passenger taxes and ground costs and some reconfiguration costs. The Audit Division concluded that the Primary Committee billed press travelers less than their pro rata share of the total amount the Primary Committee actually paid on the Swift Air contract, leaving an amount that the Primary Committee had paid on the contract but did not bill. Consequently, the General Committee billed press travelers *more* than 110% of their pro rata share of the amount the *General Committee* actually paid on the contract because the General Committee's calculation included a portion of the entire contract that had been paid by the Primary Committee.

III. EXCESSIVE MEDIA REIMBURSEMENTS ARE DETERMINED BY CALCULATING ACTUAL TRAVEL COST

A. The General Committee and The Audit Division Disagree on How to Calculate Actual Travel Cost

The crux of the disagreement between the General Committee and the Audit Division is which accounting method should be used to calculate the "actual costs" portion of the calculation of passengers' pro rata share of actual travel costs under 11 C.F.R. § 9004.6(a). The General Committee argues its accounting method, in combining the contract cost of both committees, was more reasonable than the auditors' accounting method given that the contract price was not directly proportional to the actual use of the aircraft over the period of the contract. While the auditors' method relied on the cost that each committee paid under the contract, the General Committee argues that the cost that the committees were paying for the contract was not directly reflective of the flight hours that they were using as they proceeded through the campaign.

As a legal matter, however, we question whether the Commission should apply the General Committee's approach because it requires the Commission to combine the contract cost and use of both the Primary Committee and the General Committee. The problem with the General Committee's argument is that its method may accurately reflect the comparative actual use of the aircraft between the two committees but it is not in proportion to the comparative actual costs paid by the two committees. And because, of the two committees, the General Committee is the only one that is publicly financed and the only one that is the subject of this audit, it is the "actual cost," 11 C.F.R. § 9004.6(a), to the General Committee with which we are concerned here.

The public financing rules allow general election committees to seek limited reimbursements from the media for travel expenses. See 11 C.F.R. § 9004.6(a)(2) and (3). "The amount of reimbursement sought from a media representative . . . shall not exceed 110% of the media representative's pro rata share (or a reasonable estimate of the media representative's pro rata share) of the actual cost of the transportation and services made available." 11 C.F.R. § 9004.6(b)(1). The pro rata share is calculated by "dividing the total actual cost of the transportation and services provided by the total number of individuals to whom such transportation and services are made available."¹ 11 C.F.R. § 9004.6(b)(2). While we can apply this regulation to the travel expenses of one committee operating in one election, neither the regulation itself, nor its Explanation and Justification provide a formula for calculating the actual cost of air travel on a chartered airplane used by two committees in two different elections (primary and general).

¹ The travel reimbursement rule at section 9004.6 has changed in some ways over the years, but the Commission has consistently stated that committees should determine the media representative's pro rata share of the "actual cost" of the transportation. See, e.g., Explanation and Justifications for 11 C.F.R. § 9004.6, 45 Fed. Reg. 43,376 (June 27, 1980); 56 Fed. Reg. 35903 (Jul. 29, 1991), 60 Fed. Reg. 31,858-59 (June 16, 1995), 64 Fed. Reg. 42,581 (Aug. 5, 1999).

The auditors' calculation of the actual cost of the Swift Air contract and related costs is simple. The auditors determined that the actual cost was the amount paid by the General Committee to Swift Air for travel during the general election period. The calculation was based on the weekly installment payment of \$336,000 and additional costs, the weekly flight hours, and the number of passengers. The Audit Division's method indicates that the General Committee billed the press and received reimbursements from the press, not only for the amounts the General Committee paid to Swift Air during the general election period, but also for a portion of the travel costs that the Primary Committee paid to Swift Air for primary campaign transportation attributable to the primary campaign.

The Audit staff's calculation is appropriate because the cost of the Swift Air contract paid for and used by both the primary and general campaigns should be divided based on the amount each committee actually paid for travel during the primary or general campaign. The regulatory history provides no guidance about how to determine the "actual cost" in a case like this one, where a candidate's primary and general committees shared a contract for use of the same leased *airplane*. But the Commission has noted, in addressing what types of costs could be charged to the media as the "actual cost" of *ground* transportation and facilities, that "campaigns should already be well aware that each media representative may only be charged his or her own pro rata share of costs" and "committees may not force the traveling press to absorb the costs" of services "used or consumed" by others. Explanation and Justification for 11 C.F.R. § 9004.6, 64 Fed. Reg. 42,581-2 (Aug. 5, 1999). *Id.* at 42,582. This reasoning would support the conclusion that media traveling with a candidate's general election campaign should pay only for general election period travel and not be forced to absorb air travel costs more properly viewed as attributable to the candidate's primary campaign, and specifically to the media who traveled with that campaign.

B. The General Committee's Actual Cost Should Be Based On The Travel Cost Paid By The General Committee

The General Committee's press billing and reimbursement calculation should be based only on the General Committee's payments for travel in furtherance of the general election campaign during the general election period. The General Committee cannot incur primary-related travel expenses because they are not in furtherance of the general election campaign. See 26 U.S.C. § 9002(11); 11 C.F.R. § 9002.11. As the General Committee cannot incur expenses for primary-related travel, it should not be able to effectively bill the press for those costs either. The publicly-funded General Committee and McCain's non-publicly funded Primary Committee should keep their expenses separate because the two campaigns operated under different rules, requirements and limitations. Senator McCain agreed to use only public funds for his general election campaign; to take no contributions; and to keep his spending within the general election expenditure limitation, which equals the amount of public funds he received. See 26 U.S.C. §§ 9002(11), 9003(b); 2 U.S.C. §§ 441a(b)(1) and (c); 11 C.F.R. § 9002.11. By

contrast, Senator McCain opted not to participate in the primary matching payment program; his primary campaign was entirely privately funded.

Because primary and general election campaign expenditures must remain separate, the Commission created "bright line" rules for attributing expenses between the primary and general expenditure limitations after issues arose in prior election cycles about how to divide expenses that benefitted both campaigns between publicly funded primary and general committees. 11 C.F.R. § 9034.4(e); see Explanation and Justification for 11 C.F.R. § 9034.4(e), 60 Fed. Reg. 31,854 at 31,866-68 (Jun. 16, 1995). These rules were later revised to also apply to this situation, where the candidate received public funds in only one election. *Id.* Many of these bright line rules are based on timing. Under the bright line attribution rules, travel costs are attributed based on when the travel occurs. 11 C.F.R. § 9034.4(e)(7). If the travel occurs before the date of the nomination, the cost is a primary expense, unless the travel is by a person working exclusively on general election campaign preparations. *Id.* While these bright line rules are normally applied to situations to determine the attribution of travel costs to a primary and general campaign sharing expenses, we believe that it is appropriate for the Commission to use these same rules to determine the attribution of the travel costs between these committees and how much these committees should bill the press for travel costs.

Under the bright line attribution rules, the General Committee's weekly payments to Swift Air were for general expenses and the Primary Committee's weekly payments were for primary expenses because the weekly payments appear to be related to the weekly use of the leased plane. Although the General Committee contends that each weekly installment payment was not in exchange for that week's flight hours, PAR Response at 5, it has not provided any documentation or explanation demonstrating that there was no connection between the weekly payments and the weekly flight hours. To the extent that the payments and the amounts billed to the press were related to travel occurring at the same time as the payments were made, those amounts were attributable to the Primary Committee prior to the date of the candidate's nomination and to the General Committee after the date of the candidate's nomination. See 11 C.F.R. § 9034.4(e)(7).

The regulations also allow a limited exception for qualified campaign expenses incurred prior to the general election expenditure report period for property, goods or services to be used during the expenditure report period in connection with the general election campaign. 11 C.F.R. § 9002.11(a)(2), 9003.4, 9004.4. The Commission explained that this exception is "designed to permit a candidate to set up a basic campaign organization before the expenditure report period begins." Explanation and Justification for 11 C.F.R. § 9003.4, 45 Fed. Reg. 43375 (Jun. 27, 1980). The rule lists examples of expenses such as establishing financial accounting systems and organizational planning. 11 C.F.R. § 9003.4(a).

The General Committee has not demonstrated that the Primary Committee's weekly lease payments were related to travel after the date of nomination or that travel during the primary period was by persons who were working exclusively to prepare for the general election. See 11 C.F.R. § 9034.4(e)(7). Nor has it demonstrated that the Primary Committee was somehow pre-paying for the General Committee's use of the leased plane during the general election period. See 11 C.F.R. § 9003.4(a). Both campaigns paid the same weekly amount for the leased plane and both campaigns used the leased plane. Although unused hours rolled over from week to week, neither committee used all of the flight hours they could have used under the contract.²

In addition, the separate reporting of expenditures by these separate committees supports the conclusion that General Committee and Primary Committee travel expenditures must remain separate. The General Committee and the Primary Committee file separate reports and are separate committees.³ Publicly funded authorized committees shall report all expenditures to further the candidate's general election campaign in reports separate from reports of any other expenditures made by those committees with respect to other elections. 11 C.F.R. § 9006.1.

IV. PAST COMMISSION AUDITS DO NOT SUPPORT THE GENERAL COMMITTEE'S ARGUMENTS

The draft DFAR addresses the General Committee's argument that its calculation method is more consistent with the General Committee's interpretation of previous audits including Kerry-Edwards 2004, Dole-Kemp 1996, and Bush-Cheney 2000.⁴ We agree with the discussion of these audits in the draft DFAR, but we suggest that the Audit Division slightly expand the discussion of the General Committee's argument concerning the Kerry-Edwards 2004 audit.

The Committee contends, and it is correct, that the Kerry-Edwards air charter lease "straddled the primary and general-election periods," like the Swift Air contract. PAR Response at 7. The Committee, however, is incorrect in assuming that there must have been similar issues in calculating the costs for press reimbursements where the Kerry Edwards general committee reimbursed the primary committee for "banked" flight

² If the General Committee is able to demonstrate that some portion of the Primary Committee's contract payments was to further the general election and should have been paid for by the General Committee, its actual cost of travel and the amount it may bill the press might increase. We recommend that the Audit Division specifically note this issue in the DFAR.

³ Generally, publicly funded general election candidates set up a separate authorized committee for the general election, which they authorize to incur expenses on their behalf, as well as a separate legal and compliance fund. See 26 U.S.C. §§ 9002(f); 11 C.F.R. §§ 9002.1, 9002.2, 9003.3.

⁴ The draft DFAR also addresses the General Committee's arguments based on GAAP accounting principles. We defer to the Audit Division's expertise in analyzing the correct application of accounting and auditing principles and procedures.

hours used by the general committee, *id.* at 8, because, according to the Audit Division, the Kerry-Edwards general committee did not use the plane in question to transport the press.⁵ To assist the Commission, we recommend that you include this information about the Kerry-Edwards audit in the DFAR's discussion of past Commission audits.

The General Committee also cites several audits that it had relied upon in prior responses, Dole-Kemp 1996 and Bush-Cheney 2000. The General Committee argues that its calculation method was structured to match past Commission audits and that it used the same method the auditors used in the Dole-Kemp audit, dividing the total amount of payments made under the lease by the number of actual flight hours, to predict the travel costs attributable to the General Committee. PAR Response at 5-6. The Committee asserts that it does not matter that the Dole-Kemp contract only covered the general election period. *Id.* The Committee states that Bush-Cheney 2000's lease covered the primary and general election periods and was structured in a nearly identical way to the Swift Air contract, and the Bush-Cheney campaign used the same billing methodology as the General Committee did for the Swift Air contract. *Id.* at 8. It argues that there was no press finding in the Bush-Cheney 2000 Final Audit Report, and the Audit Division did not "even communicate informally any objection over calculation methodology." *Id.* It contends that even if the overbilling of the press in that audit was not material, the "Audit Division still should have given notice of methodology errors" and the "Commission's acquiescence in a recordkeeping practice has precedential value because silence is reasonably construed by the audited party as approval." *Id.*

We concur with the Audit Division's discussion of these past Commission audits in the draft DFAR. The General Committee seeks to apply the hourly calculation used in the Dole-Kemp 1996 audit to the total Swift Air costs over the life of the entire contract for both the General Committee and Primary Committee, and not, as in Dole-Kemp 1996, to a general election committee's portion of the costs for travel during the general election campaign. The Bush-Cheney 2000 committee may have used a similar billing methodology to the General Committee, but that method did not result in any material overbilling of the press or audit finding in that audit. The absence of a finding in that audit does not indicate the approach or billings by the Bush-Cheney 2000 committee were correct. It merely indicates that the difference between the committee's and auditors' calculations in that audit was not large enough to raise an issue of material noncompliance.

⁵ Moreover, in contrast to this audit, where both committees used less than the flight hours they paid for, the Kerry-Edwards general committee actually paid the Kerry primary committee for the "banked" flight hours used by the general committee (i.e., hours originally paid by the Kerry primary committee, but not used by it). We presume that if the Kerry-Edwards general committee had used the plane to transport the press, the Audit Division would have included these payments to the Kerry primary committee in the Kerry-Edwards general committee's "actual cost." 11 C.F.R. § 9004.6(b)(1). Please advise us if this is not the case.

However, you may wish to address whether this issue arose in any prior audits in such a way that the General Committee would have been on notice that its choice of accounting method might have negative consequences.

V. PROPOSED TRANSFER TO PRIMARY COMMITTEE WOULD NOT RESOLVE ISSUE

The General Committee's final argument is that if there is a "misallocation" of press reimbursements, it should not have to make any refunds to press entities, but instead may correct the imbalance with a transfer from the General Committee to the Primary Committee. PAR Response at 11-13. The General Committee argues that such a payment would not result in qualified campaign expenses. *Id.* It contends that the Commission has previously permitted transfers from publicly funded general committees to primary committees to correct similar misallocation issues and cites Kerry-Edwards 2004 as an example of the payment by the general committee to the primary committee for a misallocation of joint reconfiguration costs and banked flight hours. *Id.* at 12-13. It asserts that the transfer itself would not be any type of expense because the Committees are affiliated and may make unlimited transfers. *Id.* at 12. The General Committee also contends that the restriction limiting its spending to qualified campaign expenses applies only to the public funds it received, and not to funds it received from other sources, such as press reimbursements. *Id.* It contends that the transfer will not result in the General Committee incurring non-qualified primary expenses because three years have passed and any funds transferred are unlikely to be used to defray any primary activity, and the Primary Committee already paid for press travel without recouping its full travel costs. *Id.* Last, the General Committee argues that the Commission should permit a transfer because the issue was caused by the Commission's failure to provide advance guidance on press reimbursement calculations. *Id.* at 13. Alternatively, the Committee requests permission to disgorge the press reimbursements to the Treasury. *Id.*

The General Committee's proposed transfer of funds to the Primary Committee will not resolve the issue that the General Committee received reimbursements from the press in excess of its actual travel cost. The amount of excess press reimbursements the General Committee received should be returned to the media representatives. 11 C.F.R. § 9004.6(d)(1). The fact that the General Committee overbilled the press and the Primary Committee could have billed the press more than it did does not mean that the General Committee owes the excess press reimbursements it received to the Primary Committee. Moreover, as previously noted, the General Committee has not demonstrated that the Primary Committee paid Swift Air more than its share of the contract costs to cover travel costs used by the General Committee during the general election period. In previous Commission audits where a general committee reimbursed a primary committee, such as the payment for banked hours in Kerry-Edwards, the Commission required the reimbursement because one committee had paid for goods or services that were actually used by the other committee. But here, the General Committee does not owe any reimbursement to the Primary Committee.

Moreover, if the General Committee's public funds are transferred to the Primary Committee and used to pay for any primary campaign expenses, the payments would be non-qualified campaign expenses that may be subject to repayment because they would not be made to further McCain's campaign for the general election. See 26 U.S.C. §§ 9002(11), 9007(b)(4); 11 C.F.R. §§ 9002.11, 9004.4, 9007.2(b)(2). While the General Committee might be able to transfer funds to the Primary Committee, the Primary Committee could not then use the funds for any primary expenses such as debts without causing the General Committee to make a non-qualified campaign expense. All of the General Committee's funds must be used only for qualified campaign expenses; there is no exception for press reimbursements received.⁶ See 11 C.F.R. §§ 9002.11, 9004.4. Because press payments reimburse campaigns for some of the public funds spent on travel costs, reimbursements retain their character as public funds. Whether or not the Commission provided advance guidance on press reimbursement calculations, the proposed transfer would not resolve this issue.

The General Committee should pay the excess reimbursements to the press. The regulations require committees to return reimbursements in excess of 110% to the media representative. 11 C.F.R. § 9004.6(d). Only amounts that are less than 110% but exceed the actual cost of travel plus a percentage for administrative costs should be paid to the Treasury. *Id.* In other contexts, the regulations provide for payment to the Treasury for stale-dated checks, 11 C.F.R. § 9007.6, and disgorgement payments for the amount of prohibited and excessive contributions identified by a sampling method in an audit. 11 C.F.R. § 9007.1(f). Payment to the Treasury is appropriate in those instances because of the difficulty of resolving situations where payees have not cashed committee checks or the audit sample does not identify specific contributors for refunds. Similarly, disgorgement to the Treasury might be appropriate here if the General Committee is unable to reconstruct the precise amounts owed to each individual press entity, or if the payees cannot now be located.

⁶ Fully publicly funded general election candidates must agree not to accept any private contributions, 11 C.F.R. § 9003.2(a)(2); thus, their expenditures are equal to the public funds received. The only funds that are not subject to the public funding use restrictions are private contributions in a general election legal and accounting compliance fund. See 11 C.F.R. § 9003.3.